

CHAPTER 1

INTRODUCTION

The U.S. Department of Agriculture's Farm Service Agency (FSA) purchases food products for distribution through several of the Department's food assistance programs. The products are then delivered to client agencies, such as school systems and social service organizations, which in turn distribute the products to needy households. FSA purchases food products throughout the year, using methods that economists refer to as auctions. An auction is a bidding mechanism that encompasses a set of auction rules, which in turn specify how potential bidders may participate in the auction; how the winner is determined; and how much, in the case of procurement auctions, the winner is to be paid (McAfee and McMillan, 1987; Wolfstetter, 1996). Auctions are widely used in government procurement activities, and are also used to distribute oil drilling and timber harvesting rights on Federal property, and to finance Federal activities through the sale of Treasury bills. In the private sector, auctions are used to sell such products as wine, art, flowers, fish, and tobacco, and to solicit delivery price offers for products ranging from office supplies to tires to construction jobs.

In the fall of 1996, FSA asked the Department's Economic Research Service (ERS) to evaluate the agency's system for procuring and distributing food products. This report summarizes that work, and is based on three sources of information. First, ERS researchers conducted a series of interviews with participants in the process, including FSA employees and clients, people at other government agencies with responsibilities for food procurement, and private sector food processors and distributors. Second, we acquired

summary expenditure and quantity data from FSA and from other government agencies. Finally, we developed a large database, using FSA administrative records, on the results of separate procurement auctions and performed extensive statistical analyses of those auctions. We focused particularly on the determinants of bid prices in FSA auctions and compared those prices to commercial prices for the same products.

Chapters 2 through 4 describe the environment within which FSA carries out its procurement activities. We first provide an overview of the largest Federal food procurement agencies. In particular, we describe the differences among USDA, the Department of Defense, and the Department of Veterans Affairs in procurement goals and methods, and describe recent major changes in procurement methods at the latter two Departments. We then detail, in Chapter 3, USDA's food procurement programs—the agencies and food assistance programs involved, the statutory framework that drives USDA programs, and recent expenditure patterns. Chapter 4 provides a detailed description of the actual steps involved in purchases administered by FSA.

In the fifth chapter, we build on the material introduced earlier, and describe a set of policy issues that relate to FSA procurement. That is, a set of specific rules currently constrains FSA to purchase quite specific products, with customized packaging, and requires an extensive system of onsite inspection of USDA's food products. We summarize those rules, identify their interlinkages, and discuss potential alternatives.

Moreover, current FSA procedures could be modified in a variety of ways. We discuss potential modifications and their possible effects.

Chapters 6 through 8 rely on the large database of FSA purchase records. We first discuss the construction of the database in chapter 6, and summarize the key price, volume, competition, and product measures in the data. In chapter 7, we report the results of our statistical analysis of bid prices in FSA purchases. We estimate the effects of agricultural commodity prices, product and packaging characteristics, purchase volumes, and competition on bid prices in five FSA commodity categories over a 5-year period. The results should help FSA to identify the major factors behind actual and forecast changes in product prices and to plan for tacti-

cal changes in policies aimed at improving performance.

We use the analyses of chapters 6 and 7 to develop measures of average FSA prices in chapter 8, measured at particular times and locations. The chapter then compares those average prices to commercial price quotes for those products, times, and locations. The data provide evidence of the price advantages that FSA can deliver to its clients, as well as the sources of those advantages; in short, it summarizes FSA's relative strengths and weaknesses in food procurement and distribution. A concluding chapter summarizes our major positive and negative findings, and offers some recommendations for FSA auction strategy.